

**OPENING STATEMENT OF REP. EDWARD J. MARKEY (D-MA)**  
**HOUSE SUBCOMMITTEE ON FINANCE AND HAZARDOUS MATERIALS**  
**OVERSIGHT HEARING ON THE MARKET IMPACT OF THE**  
**PRESIDENT'S SOCIAL SECURITY PROPOSAL**

**WEDNESDAY, MARCH 3, 1999**

Thank you, Mr. Chairman. I'd like to begin by commending you for calling this second oversight hearing on the market impact of the President's Social Security proposal.

If we are going to invest a portion of the Social Security Trust Fund in the stock market, we basically have three choices. First, we could establish privately managed individual accounts. Second, we could create individual accounts that are centrally managed through a government sponsored entity like the Federal Thrift Savings Plan. Third, we could maintain the defined benefit nature of the Social Security program, while investing a portion of Social Security Reserves in broad index funds using a Thrift Savings Plan-like investment structure. This third approach is what the President has endorsed and what the bipartisan legislation I have introduced with Representatives Bartlett, and Pomeroy would implement.

Our bill contains six principal safeguards that will insulate the Social Security Investment Fund from the risks of political influence or social investing:

1. We establish an independent agency to oversee the investments, governed by a Board appointed for 10 year staggered terms.
2. We bar the Board or the Executive Director of the Investment Fund from doing any individual stock picking or voting of shares.
3. We bar the Board or Executive Director from picking any stock index fund based on political, social or religious considerations, and direct them instead to focus on maximizing returns and minimizing administrative costs.
4. We require that the actual investing be done by professional money managers who have substantial private assets under management.
5. We limit any one money manager to controlling 1% or less of any of the total common stock of a company that is on the index or indexes selected for the Fund.
6. We direct that the managers "mirror vote" their shares in the same percentage as all of the other shares are voted (so that the Fund remains neutral in any corporate governance matter).

Today we will be hearing from one of the most thoughtful and influential critics of the President's approach. I look forward to hearing Chairman Greenspan's views on our legislation, as well as that of Deputy Treasury Secretary Summers, who will be appearing this afternoon. But as we debate the merits of this proposal, I am reminded of something my mother always said: "One of the biggest questions in life is: compared to what?"

So, let's take a look at the privately managed private account alternative. The French have a saying that when you want to get to the bottom of any mystery: "Cherchez la femme." Here, if want to find out what is really driving interest in private accounts, you simply need to "Cherchez la fee." And you don't have to search very long here to discover that the fees associated with privately managed individual accounts are quite substantial – consuming 20 percent of the funds in an account over the course of a forty year

work career and an additional 10-15 percent in converting that individual account into an annuity. That's billions of dollars that could have supported the retirement of Main Street instead supporting vacation homes for Wall Street brokers.

And what of the government-managed private account option? The basic structure and governance of such a program would be similar to the Bartlett-Markey bill. You would still face the risks of political interference in corporate governance matters or social investing. The aggregate size of the investments being made would be about the same. And, you would still have to face the costs and complications of converting these accounts to annuities.

What other additional political risks might such private accounts schemes face? When Congress originally created IRAs, they were to be used only for retirement savings. But now IRA funds can be diverted to purchase a home or pay educational expenses. Will we be any more successful in insulating Social Security private accounts from the inevitable political pressures to make these funds available for similar purposes?

Moreover, if there is a recession, will Congress be able to withstand the demands from the public that they be allowed to withdraw funds from their individual accounts to alleviate their immediate economic distress? And what happens to these individual accounts when the beneficiaries reach retirement age? Will we mandate their conversion into annuities? If so, what happens to those who gamble away their savings with bad investments, or simply have the bad fortune to retire during a sustained Bear market? For such individuals, converting one's recently depleted investment account into an annuity would condemn the retiree to receive a substantially smaller monthly annuity check than those who had the good fortune to retire and annuitize during boom times? Will we facing new generations of Stock Market Notch Babies demand that Congress make them whole?

Mr. Chairman, when we begin to examine the consequences of some of these alternatives, I believe the Subcommittee will ultimately come to the conclusion that the approach set forth by the President is the best way for us to proceed. I look forward to the testimony from our witnesses, and I yield back the balance of my time.

### QUESTIONS FOR ALAN GREENSPAN

Chairman Greenspan, you have expressed concerns about potential risks you believe are associated with the President's proposal. But I would like to ask you about some of the risks represented by the alternatives you have previously indicated you supported. **Given the very severe time constraints, I'm going to have to ask you to give me very short responses – yes's or noes if possible – O.K.?**

Great. Let's begin with privately managed individual accounts. Now, the Advisory Council on Social Security has estimated that the administrative costs and fees of a privately managed individual account would average at least one percent per year, and other studies show that mutual funds that invest in stocks have annual fees averaging between 1 and 1.5 percent per year, isn't that right? [Yes or No]

*Yes. [FYI: This is a conservative number. By comparison, the Investment Company Institute reported last year that the average costs of an equity mutual fund per year was 1.49 percent a year, and Lipper Analytical Services has reported that the average charge on a no-load equities mutual fund equaled 1.21 percent of the amounts invested in the funds.]*

So, assuming there's a one percent per year fee, each dollar deposited in an individual account in the first year of a 40-year career would be subject to the one percent fee 40 times, while a dollar deposited

in the final year before retirement would be subject to the fee once. This means that on average, dollars in the account will be subject to the one percent annual charge roughly 20 times, or approximately 20% of the account will be consumed by these charges – isn't that right?

*Yes. [FYI: The 20% costs is roughly consistent with what actually happened in Chile and the UK, which have seen between 20 and 25% of returns reduced by fees and expenses.]*

Now, Isn't it also true that the actual amounts consumed would generally be larger than 20% on smaller-than-average accounts and smaller than 20% for large accounts?

*Yes. [FYI: At the Subcommittee's 7/24/98 hearing Joel Dickson, Senior Investment Analyst from Vanguard testified that "...lower-income and part-time workers will have small account balances, potentially subjecting them to higher fees because asset-based revenue cannot begin to cover the costs of maintaining these accounts. Thus, they are likely to earn lower returns than higher-income workers that make the same investment choices for reasons unrelated to financial market sophistication]*

Now, if the funds that have been accumulating in an individual account over that 40-year period were to be converted into an annuity upon retirement, isn't it true that there would be additional fees and expenses that could consume at least an additional 15-20% of the savings in the account?

*Yes [FYI: The leading study on this subject by the National Bureau of Economic Research found that fees charged for converting an individual account to an annuity at retirement consumes an average of 5-10% of the retirement savings of an individual purchasing a \$100,000 annuity. In addition, however, prices for annuities are generally raised by an additional 10% to cover "adverse selection" risks (i.e., risk that an individual with a longer life expectancy will purchase an annuity)]*

So, isn't it true then that at least 30-35 percent of the amounts deposited into an individual account could end up being eaten up in fees and expenses?

*Yes. [FYI: Add the 20% administrative cost of the 1% annual fee plus the 5-10% cost of annuitization plus another 10% for "adverse selection risk" and you get 35-45%. So, to be conservative, let's lowball it at 30-35%]*

So, wouldn't you also agree that a privately managed individual account would have to substantially outperform a passive indexed, centrally managed fund in order to make up for all of the annual fees and expenses and annuitization costs?

*Yes.*

Now, isn't it also true that it is unlikely to happen, given the fact that today the passively managed index fund that tracks the S&P500 routinely outperforms most actively managed equity mutual funds?

*Yes.*

Now, the annual fees associated with a centrally managed individual account have been estimated by MIT economist Peter Diamond to consume approximately 7.5 percent of the funds in an average worker's account over the same 40 year work-life, which is better than losing 20% of your savings. But such plans still would have to be converted into an annuity upon retirement, wouldn't they?

Yes.

You certainly wouldn't view cutting a check and giving the retiree a lump sum upon retirement, would you?

No.

Now, isn't it true that the basic structure and governance of a government-managed private account system would be pretty similar to the Bartlett-Markey bill?

Yes.

So, you could still have the same risk of political interference in corporate governance matters or social investing under that system couldn't you?

*Yes, the governance would be similar. But the fact that its a defined contribution plan as opposed to a defined benefit plan provides additional protection.*

Now, notwithstanding your view that the program would be better insulated against political interference if it were a defined contribution rather than a defined benefit plan, wouldn't you agree that Social Security has not been called the "third rail of American politics" for nothing? It seems to me that the "annuitants" in the current system – seniors – have historically been quite sensitive to any potential threats to the system, wouldn't you agree?

Yes.

Wouldn't you also agree that it would be prudent for us to consider what other additional risks might a private accounts scheme might face?

Yes.

Now, I mentioned earlier that when Congress originally created IRAs, they were supposed to be used only for retirement savings. But now money can be withdrawn from IRAs and used to help purchase a home or pay educational expenses. Isn't that right?

Yes.

Isn't it possible that Congress will be no more successful in insulating Social Security private accounts from the inevitable political pressures to make these funds available for similar purposes than it was in limiting the IRA for retirement savings only?

Yes.

If there is a recession, isn't it possible that Congress would face demands from the public that they be allowed to withdraw their own funds from their own individual accounts right now to alleviate their immediate economic distress?

Yes.

And what happens to individual accounts when beneficiaries reach retirement age? Will we mandate

their conversion into annuities? If so, what happens to those who have gambled away their savings with riskier investments, or simply have the bad luck to reach retirement during a sustained Bear market (such as that which occurred from 1971 to 75, when the market dropped 65% in value)? In that situation, converting one's recently depleted investment account into an annuity would condemn the retiree to receive a substantially smaller monthly annuity check than those who had the good fortune to retire and annuitize during boom times? Will new generations of Stock Market Notch Babies come beating down the doors demanding that Congress make them whole. Will we be able to resist those pressures then? What should we do then?

And retirees with serious medical problems or terminal illnesses? What about them? Will we -- or should we -- force them to accept a lifetime annuity they won't be able to fully enjoy when what they really want is a lump sum payment of their own money right now?

Why wouldn't it be safer to retain a system that provides a defined benefit and uses the efficiencies of a centrally managed fund to reap the benefits of the higher yields available in the stock market over the long term?